United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-2147

(D.C. Civil No. 73 Civ. 3557)

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 74-2147

HARRY ERNEST RUBENS AND JEANNE RUBENS,
Plaintiff-Appellants

v.

NEW YORK STOCK EXCHANGE, INC., KIDDER, PEABODY & CO., INC., MERRILL LYNCH, PIERCE, FENNER & SMITH INC.,
Defendant-Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANT-APPELLEE NEW YORK STOCK EXCHANGE, INC.

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This is an appeal from orders of the United States District Court for the Southern District of New York (Brieant, J.) dated March 18, 1974 (144-152)*, and July 16, 1974 (223-225)**, which granted summary judgment in favor of defendants Kidder, Peabody & Co., Inc. ("Kidder") and Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch") and dismissed the complaint as to defendant New York Stock Exchange, Inc. (the "Exchange"). In substance, plaintiffs challenge the method by which the defendant brokers have computed

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* Page references are to the Joint Appendix on this appeal.

** Plaintiffs also purport to appeal from an order dated October 9, 1973 (99-101), which stayed the action pending completion of an existing arbitration proceeding.

the interest charges on their accounts and a clause in the Customer's Agreements which they signed with Kidder*, providing that controversies relating to those accounts "shall be settled by arbitration in accordance with the rules of either the American Arbitration Association or the New York Stock Exchange" as the customer may elect.

The complaint (1-10) alleges that the actions of Kidder and Merrill Lynch, in collecting those charges and circulating such Customer's Agreements, constitute a violation of the antifraud sections of the Securities Exchange Act. It further alleges, in the third and fourth causes of action, that the Exchange "conspired to permit" these other defendants to do their allegedly wrongful deeds. Apart from this passive conspiracy theory, wholly unsupported by evidentiary facts, the only allegation against the Exchange is that the other defendants are members of it.

The Exchange's answer (153-154) denies the existence of any such conspiracy, or commission of any wrongful act by it, and denies knowledge of the truth of the plaintiff's allegations against Kidder and Merrill Lynch. Having found no merit to plaintiff's claims against those other defendants, the District Court dismissed the complaint as to the Exchange *sua sponte* (225).

Statement of Issue

Whether the plaintiffs have a cognizable claim against the Exchange.

Summary of Argument

Plaintiffs have failed to state a claim against the Exchange upon which relief can be granted. Insofar as the orders appealed from relate to an arbitration held in accordance with the rules of the Exchange, the District Court

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* The Exchange is not privy to its members' decisions with respect to the incorporation of arbitration clauses in their written agreements with customers. Some members of the Exchange include such clauses and some do not.

correctly held that plaintiffs' claims against Kidder were arbitrable at the election of plaintiffs.

Statement of Facts

Commencing in October 1967 and June 1968, respectively, plaintiffs' accounts with Kidder and Merrill Lynch were debited for interest charges incurred in connection with their sales of securities "short against the box." (14-18, 158-160, 224-225)

In January 1970 (some two years later) plaintiff Harry Rubens wrote to Kidder requesting an explanation of these charges. (54) Apparently dissatisfied with Kidder's response, both plaintiffs commenced actions against it in the Small Claims Part of the Civil Court of the City of New York in September 1970 seeking recovery of "interest charges not incurred." (18, 56-57) In November 1970 those actions were stayed until May 3, 1971, pending arbitration pursuant to written agreements between Kidder and both plaintiffs. The agreements afforded plaintiffs the choice of arbitrating their claims in accordance with the rules of "*either* the American Arbitration Association *or* the New York Stock Exchange." [Emphasis added] (18, 24-27, 59) On May 3, 1971 those actions were dismissed for lack of prosecution.

On May 17, 1971 plaintiff Harry Rubens wrote to the Exchange's Division of Inquiries and Complaints, complaining of Kidder's interest charges. (62) A copy of Mr. Rubens' letter was forwarded to Kidder with a request that it advise that division of its position with respect to his complaint. (61) This routine method of initiating an investigation is apparently regarded by Mr. Rubens as evidence of a conspiracy between Kidder and the Exchange. (97, ¶ 15)

In November 1972 both plaintiffs submitted their claims against Kidder for arbitration pursuant to the Exchange's rules for the arbitration of non-member controversies.

(73-83) In accordance with Article VIII, Sections 4 and 6 of the Exchange's Constitution, such controversies are accepted for arbitration only "at the instance of [the] non-member" and (unless the non-member otherwise elects) are heard and determined by a mixed panel of five arbitrators, three of whom are "not engaged in the securities business." (78) In accordance with the arbitration clause of their Customer's Agreements with Kidder (25, 27), plaintiffs were not required to submit this controversy to the Exchange, but could, instead, have elected to have it arbitrated by the American Arbitration Association.

In August 1973, while that arbitration was pending before the Exchange (20), plaintiffs commenced this action. (iii)

In January 1970 plaintiff Harry Rubens had also written to Merrill Lynch, requesting an explanation of the interest charges debited to his account in June 1968. (163) After an unsuccessful attempt to explain to Mr. Rubens' satisfaction the justification for the charges which it had made, Merrill Lynch refunded the interest which it had charged on the ground that "when you established the short position against the box, you did not fully understand our procedures." (160-161, 169-173) Receipt of this refund was acknowledged by Mr. Rubens in November 1970. (179, 192) Notwithstanding this repayment, Merrill Lynch was also named as a defendant in this action.

On October 9, 1973, the action was stayed pending completion of the arbitration proceedings then in progress (101) and on October 17, 1973, the arbitrators rendered their decision (107-108). Plaintiffs "failed to move for an order modifying or vacating the award" (149), relying instead upon the argument that their claims against Kidder were utterly unarbitrable under *Wilko* v. *Swan,* 346 U.S. 427 (1953) (126-128). The District Court disagreed, ruling that the *Wilko* doctrine "does not bar submission of an existing controversy to arbitrators" and that, in any event, "plain-

tiffs' allegations of fraud appear insufficient to support a Rule 10b-5 action." (144-152) In disposing of the balance of the action (as against Merrill Lynch and the Exchange), the District Court found that "[e]ven in the absence of the return of the money, no claim is stated, on these undisputed facts, where a usual and normal sale 'short against the box' was carried out in a proper manner." (225)

POINT I

Plaintiffs have failed to state a claim against the Exchange upon which relief can be granted.

Plaintiffs are apparently dissatisfied with the method by which Kidder and Merrill Lynch have reckoned their interest charges on sales of securities "short against the box." The complaint, in its causes of action alleged against the brokers, asserts that this interest was "fraudulently charged" in violation of Section 10 of the Securities Exchange Act.

As against the Exchange, the complaint alleges, in wholly conclusory terms, a fraudulent conspiracy "to permit" such charges [third cause of action] and "to compel arbitration" of plaintiffs' objections to them [fourth cause of action]. Neither of these causes of action is supported by allegations of any action by the Exchange and they are clearly insufficient. As this Court stated in *Segal* v. *Gordon*, 467 F.2d 602, 607 (2d Cir. 1972):

> "Mere general allegations that there was fraud, corruption or conspiracy or characterizations of acts or conduct in these terms are not enough no matter how frequently repeated."

It would appear from the plaintiffs' affidavit in opposition to Kidder's motion for summary judgment (97) that plaintiffs base their action against the Exchange upon the mere existence of Exchange rules which, they assert, "condoned the conduct" of the brokers.

Although those rules would seem to permit the interest charges which Kidder made to plaintiffs' accounts, they are not the basis for same. Rather, as is clearly spelled out in the Customer's Agreements, it was the plaintiffs who affirmatively agreed to pay "interest in accordance with your usual custom." (16) The only requirements of the Exchange in this regard are that interest charges should accord with a broker's usual practices, and not serve as a device for an improper adjustment of commission charges. *Cf.* Rule 369(1) which prohibits "[a]n arrangement with a customer whereby special and unusual rates of interest are given or money advanced upon unusual items for the purpose of obtaining or retaining business." (15)

The claim that those customs and practices are "fraudulent" as applied to short sales against the box was rejected by the District Court (224) and, we submit, properly so. Even apart from that determination, however, it is clear that there can be no cause of action against the Exchange for "conspiracy to permit" a fraud by virtue of its mere adoption of rules referring to the customary rates of interest charged by its members.

Plaintiffs' allegations that the Exchange has conspired "to compel arbitration" of their claims against its members are belied by the facts. Neither the Exchange, nor any of its members, has compelled these plaintiffs to submit their claims to arbitration under Exchange auspices. The Customer's Agreements which plaintiffs signed with Kidder afforded them a choice of arbitration facilities and it was they who chose to submit their claims to the Exchange. (141) Indeed, for claims arising under the federal securities laws, plaintiffs had a third choice—suit in the federal courts.

Far from conspiring with Kidder to compel arbitration of plaintiffs' claims before the Exchange, the Exchange would have had no standing or reason to object if these plaintiffs had taken their claims to the American Arbitration Association (or to the federal courts in the first instance) as was their option.

POINT II

Plaintiffs' claims against Kidder were arbitrable at the election of plaintiff.

Notwithstanding *Wilko* v. *Swan, supra,* the voluntary submission of an existing controversy to arbitration is valid, even where issues are therein raised under the federal securities laws. The District Court's ruling in this regard (145) was correct. *Coenen* v. *R. W. Pressprich & Co.,* 453 F.2d 1209 (2nd Cir. 1972), *cert. denied* 406 U.S. 949 (1972); *Axelrod & Co.* v. *Kordich, Victor & Neufeld,* 451 F.2d 838 (2d Cir. 1971); *Pearlstein* v. *Scudder & German,* 429 F.2d 1136 (2d Cir. 1970), *cert. denied* 401 U.S. 1013 (1971); *Gardner* v. *Shearson, Hammill & Co.,* 433 F.2d 367 (5th Cir. 1970), *cert. denied* 401 U.S. 978 (1971); *American Safety Equipment Corp.* v. *J. P. Maguire & Co.,* 391 F.2d 821 (2d Cir. 1968); *Moran* v. *Paine, Webber, Jackson & Curtis,* 389 F.2d 242 (3rd Cir. 1968).

Having elected to arbitrate an existing dispute, plaintiffs may not undo that decision (and render in vain the efforts of the arbitrators) on the flimsy ground that their submission to arbitration was based upon a misunderstanding of the applicable law. Mr. Rubens, as an attorney, should have been aware of the binding effect of the arbitration proceedings which he elected to initiate.

Conclusion

The orders of the District Court should be affirmed.

Dated: New York, New York
January 24, 1975.

Respectfully submitted,

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